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NOTES

PRIVILEGED COMMUNICATIONS—ACCOUNTANTS AND ACCOUNTING—A Critical Analysis of Accountant-Client Privilege Statutes

There is no common-law testimonial privilege which an accountant or his client may invoke to prevent disclosure of information which the client has revealed to the accountant.[1] However, sixteen states and the commonwealth of Puerto Rico have enacted accountant-client privilege statutes.[2] These states have thus decided that,

1. Falsone v. United States, 205 F.2d 734, 739 (5th Cir.), *cert denied*, 346 U.S. 864 (1953); Gariepy v. United States, 189 F.2d 459, 463-64 (6th Cir. 1951); Himmelfarb v. United States, 175 F.2d 924, 939 (9th Cir.), *cert. denied*, 338 U.S. 860 (1949); United States v. Stoehr, 100 F. Supp. 143, 162 n.49 (M.D. Pa. 1951), *aff'd*, 196 F.2d 276 (3d Cir.), *cert. denied*, 344 U.S. 826 (1952); *In re* Fisher, 51 F.2d 424, 425 (S.D.N.Y. 1931). During the seventeenth and eighteenth centuries, when the common-law courts recognized most of the privileges now existing at common law, the activities of the accounting profession were very limited. By the time the profession had grown in size and importance, the lenient attitude of the courts toward the creation of new privileges had largely disappeared. Preston, *Federal Recognition of State Statutes Rendering Privileged Communications Between Accountant and Client*, ILL. CPA, Spring 1956, at 16.

2. ARIZ. REV. STAT. ANN. § 32-749 (Supp. 1967):

> Certified public accountants and public accountants practicing in this state shall not be required to divulge, nor shall they voluntarily divulge, information which they have received by reason of the confidential nature of their employment . . . but this section shall not be construed as modifying, changing, or affecting the criminal or bankruptcy laws of this state or the United States.

COLO. REV. STAT. ANN. § 154-1-7(7) (1963):

> There are particular relations in which it is the policy of the law to encourage confidence and to preserve it inviolate; therefore, a person shall not be examined as a witness in the following cases . . . (7) A certified public accountant shall not be examined without the consent of his client as to any communication made by the client, to him in person or through the media of books of account and financial records, or his advice, reports or working papers given or made thereon in the course of professional employment. . . .

FLA. STAT. ANN. § 473.15 (1965):

> All communications between certified public accountants and public accountants and the person for whom such certified public accountant or public accountant shall have made any audit or other investigation in a professional capacity, and all information obtained by certified public accountants and public accountants in their professional capacity concerning the business and affairs of clients shall be deemed privilege communications in all of the courts of this state, and no such certified public accountant or public accountant shall be permitted to testify with respect to any of said matters, except with the consent in writing of such client or his legal representative.

GA. CODE ANN. § 84-216 (1965):

> Any communications to any practicing certified public accountant transmitted to such accountant in anticipation of, or pending, the employment of such accountant shall be treated as confidential and not disclosed nor divulged by said accountant in any proceedings of any nature whatsoever. This rule shall not exclude the accountant as witness to any facts which may transpire in connection with his employment.

ILL. REV. STAT. ch. 110½, § 51 (1965):

> A public accountant shall not be required by any court to divulge information or evidence which has been obtained by him in his confidential capacity as a public accountant.

IOWA CODE § 116.15 (1966):

> The information acquired by registered practitioners . . . in the course of professional engagements shall be deemed confidential and privileged, and except

at least in some circumstances, evidence which might have a material influence on the outcome of a case should not be available at trial.[3] Because any communications privilege precludes judicial access to

by written permission of the clients involved . . . shall not be disclosed to any person; provided, however, that nothing contained in this section shall be construed to modify, change, or otherwise affect the criminal or bankruptcy laws of this state or of the United States.

KY. REV. STAT. § 325.440 (1962):

A certified public accountant or public accountant shall not be required by any court to divulge information or evidence which has been obtained by him in his confidential capacity as such.

LA. REV. STAT. ANN. § 37:85 (1964):

No certified public accountant, public accountant, or person employed by certified public accountant or public accountant, shall be required to, or voluntarily disclose or divulge, the contents of any communication made to him by any person employing him to examine, audit, or report on any books, records, or accounts . . . except by express permission of the person employing him or his heirs, personal representative or successors.

MD. ANN. CODE art. 75A, § 20 (1957):

Except by express permission of the person employing him . . . a certified public accountant or public accountant or any person employed by him shall not be required to . . . disclose or divulge the contents of any communication made to him by any person employing him to examine, audit or report on any books, records, accounts or statements nor any information derived therefrom in rendering professional service; provided that nothing in this section shall be taken or construed as modifying, changing, or affecting the criminal laws of this State or the bankruptcy laws.

Act 306, § 23, MICH. COMP. LAWS ANN.:

Except by written permission of the client . . . a certified public accountant, or a public accountant . . . shall not be required to, and shall not voluntarily, disclose or divulge information of which he or she may have become possessed relative to and in connection with any examination of, audit of, or report on, any books, records, or accounts which he or she may be employed to make. The information derived from or as the result of such professional service shall be deemed confidential and privileged. This section shall not be construed as prohibiting the disclosure to a third party having an interest in or relying on an opinion rendered by a certified public accountant.

MO. ANN. STAT. § 326.166 (Supp. IV, 1967):

A certified public accountant, or a public accountant, shall not be examined . . . without the consent of his client as to any communication made by the client, to him . . . given or made thereon in the course of professional employment, nor shall a secretary, stenographer, clerk, or assistant of a certified public accountant, or a public accountant, be examined, without the consent of the client concerned, concerning any fact, the knowledge of which he has acquired in his capacity. This privilege shall exist in all cases except when material to the defense of an action against an accountant.

NEV. REV. STAT. § 48.065 (1963):

An accountant cannot, without the consent of his client, be examined as to any communication made by the client to him, or his advice given thereon in the course of professional employment . . . .

N.M. STAT. ANN. § 67-23-26 (1953):

A certified or registered public accountant shall not be required by any court to divulge information or evidence which has been obtained by him in his confidential capacity as such. Provided, however, that the provisions of this section shall not apply to auditing under the supervision of the state comptroller.

PA. STAT. ANN. tit. 63, § 9.11a (Supp. 1967):

Except by permission of the client . . . a certified public accountant . . . shall not be required to, and shall not voluntarily, disclose or divulge information of which he may have become possessed relative to, and in connection with any professional services as a certified public accountant other than the examination of audit of or report on any financial statements, books, records or accounts, which he may be engaged to make or requested by a prospective client to discuss . . . Provided, however, That nothing herein shall be taken or construed as modifying,

relevant information, courts and commentators[4] generally do not receive them enthusiastically. This is especially true of statutory privileges unknown to the common law.[5] This Note will examine the policy bases for the accountant-client privilege and the reception which the privilege has received in federal and state courts. In addition, it will suggest desirable limitations on the scope of the privilege.[6]

The sixteen privilege statutes now in effect vary considerably[7] and may be classified into three groups for purposes of analysis. The first category includes the five statutes which convey the broadest privilege. Four of these contain only one significant limitation: information must have been obtained by the accountant in his confidential capacity to qualify for protection under the statute.[8] The

changing, or affecting the criminal or bankruptcy laws of this Commonwealth or of the United States.

P.R. LAWS ANN. tit. 20, § 790 (1961):

No court shall require a certified public accountant or a public accountant to divulge information or evidence obtained by him in his confidential capacity as such.

TENN. CODE ANN. § 62-114 (1955):

Certified public accountants practicing in this state shall not divulge, nor shall they in any manner be required to divulge, any information which may have been communicated to them or obtained by them by reason of the confidential nature of their employment . . . except that nothing in any section of this chapter shall be construed as modifying, changing, or affecting the criminal and bankruptcy laws of this state or the United States.

3. MODEL CODE OF EVIDENCE, comment to rule 210 (1942).

4. 8 J. WIGMORE, EVIDENCE IN TRIALS AT COMMON LAW § 2291 (McNaughton ed. 1961) [hereinafter WIGMORE].

5. United States v. Bowman, 358 F.2d 421 (3d Cir. 1966); 8 WIGMORE § 2286; 49 NW. U.L. REV. 481, 542 (1954).

6. Most accountant-client privilege statutes have been in effect for some time without receiving much attention or provoking much litigation. Arizona and Colorado have had a statute since 1960; Florida, 1931; Georgia and Illinois, 1943; Iowa and Michigan, 1929; Kentucky, 1946; Louisiana, 1908; Missouri, 1967; New Mexico, 1941; Pennsylvania, 1961; and Tennessee, 1939. Yet Annot., 38 A.L.R.2d 670 (1954), reports no cases in which a state had found occasion to construe its statute. Within the past two years, however, a number of cases which have turned upon construction of these statutes have been decided. U.S. v. Bowman, 358 F.2d 421 (3d Cir. 1966); Weck v. District Court, 408 P.2d 987 (Colo. 1966); Pattie Lea, Inc. v. District Court, 423 P.2d 27 (Colo. 1967); Ash v. Reiter Co., 429 P.2d 653 (N.M. 1967). In addition, several state legislatures have recently considered either adopting accountant-client privilege statutes or altering their present statutes. Michigan has amended it statute to include a third-party protection clause which prevents accountants and their clients from asserting a privilege against members of the public who have been injured by reliance on an accountant's audit. Act 306, § 23, MICH. COMP. LAWS (Supp. 1967). In 1967, both houses of the New York legislature passed a privilege statute by substantial margins (49 to 7 in the senate on March 21, 1967, and 115 to 0 in the house on March 30, 1967) but the governor vetoed the proposal because it did not provide adequate protection to third parties. Memorandum filed with Senate Bill No. 1965-A by Gov. Nelson A. Rockefeller (May 2, 1967). In the same year Missouri became the sixteenth jurisdiction to grant a statutory accountant-client privilege. *See* note 2 *supra* for text of statute.

7. *See* the chart on the facing page.

8. The statutes of Illinois, Kentucky, New Mexico, and Puerto Rico. *See* notes 2 & 7 *supra*. Not only do these statutes contain few of the significant limitations of other accountant-client privilege statutes, but the wording of the statutes is so poor that courts in two states have interpreted them to grant a privilege only to the accountant, not his client. *See* notes 14-15 *infra* and accompanying text.

CHARACTERISTICS OF ACCOUNTANT-CLIENT PRIVILEGE STATUTES
(express provisions only)

	ARIZ.	COLO.	FLA.	GA.	ILL.	IOWA	KY.	LA.	MD.	MICH.	MO.*	NEV.	N.M.	PA.	P.R.	TENN.
Confidentiality requirement	X	.	.	.	X	.	X	.	.	.	.	.	X	.	X	X
Crim. & Bankruptcy exceptions	X	.	.	.	.	.	.	.	X	X	.	.	.	X	.	X
Provision for client waiver	.	X	X	.	.	X	.	X	X	X	X	X	.	X	.	.
Professional capacity requirement	X	X	X	.	X	X	X	.	.	X	X	X	X	X	X	X
3d party protection clause	.	.	.	.	.	.	.	.	.	X	.	.	.	X	.	.
Public accountants included	X	.	X	X	.	X	X	X	X	X	X	X	X	.	X	.

* The Missouri statute also contains a provision that the privilege shall not operate to prevent disclosure of information material to the defense of an action against an accountant.

other statute in the first group is even broader, precluding application of the privilege only in the case of testimony about "facts" occurring *during* the accountant's employment.[9] The second, or intermediate, category includes statutes which impose one or more of the following specific limitations: (1) that the privilege does not apply in criminal or bankruptcy proceedings; (2) that the privilege operates only with regard to communications made to an accountant in the course of his professional employment; (3) that the privilege cannot be invoked if the client chooses to waive it.[10] The third category includes the two statutes which restrict the application of the privilege most severely: they contain all of the limitations of the intermediate group *and* a third-party protection clause, which prevents accountants or their clients from asserting the privilege against members of the public who have been injured by reliance on an accountant's audit.[11]

Recent state court decisions indicate that the state judiciary is unwilling to construe privilege statutes as broadly as their terms would allow. A recent Colorado decision[12] held that a corporation cannot invoke the privilege against its stockholders in a shareholders' derivative suit. In reaching this decision the Colorado court read into the state accountant-client privilege statute an exception analogous to a common-law exception to the attorney-client privilege: when several persons employ the same attorney their communications to the attorney are not privileged *inter se*. The court ruled that the same kind of exception should prevent a corporation from using the accountant-client privilege in the derivative suit context.

Other recent cases construing state privilege statutes have dealt with the question of who can properly invoke the privilege.[13] Courts in Illinois and New Mexico, faced with "broad"[14] statutes, have said that these enactments create an "accountants' privilege" which can be invoked only by the *accountant*.[15] On the other hand, the supreme

9. The Georgia statute. *See* notes 2 & 7 *supra*.

10. The statutes of Arizona, Colorado, Florida, Iowa, Louisiana, Maryland, Missouri, Nevada, and Tennessee fall into this category. *See* notes 2 & 7 *supra*.

11. The Michigan and Pennsylvania statutes. *See* notes 2 & 7 *supra*.

12. Pattie Lea, Inc. v. District Court, 423 P.2d 27 (Colo. 1967). A shareholder's derivative suit for an accounting was brought against the corporation. An employee-certified public accountant (CPA) of the corporation claimed the accountant-client privilege and refused to answer all but initial perfunctory questions. The court here rejected the argument that only certified work was privileged, though it denied the privilege for the reasons stated in the text.

13. The term "invoke," as used in this connection, will refer to the party that can ultimately control whether or not the privilege will be utilized to protect the confidentiality of a communication.

14. *See* text accompanying note 8 *supra*.

15. In Dorfman v. Rombs, 218 F. Supp. 905 (N.D. Ill. 1963), an accountant's clients brought an unsuccessful action to enjoin him from divulging information to the Internal Revenue Service. Although the decision rested on other grounds, the privilege was said to be "an *accountant privilege*, a privilege whose benefit was to inure to, and which could only be claimed by, an accountant." *Id.* at 907 (emphasis added). In Ash

courts of Florida and Colorado, interpreting "intermediate" statutes,[16] have held that the privilege can be invoked only by the *client*.[17] Curiously, no state court has indicated that it would read any type of statute broadly enough to permit *both* client and accountant to invoke the privilege.

The New Mexico and Illinois decisions point up the greatest weakness of the broadly worded statutes. Communications privileges are tolerated because they are deemed necessary to promote full and honest disclosure between the parties to certain relationships.[18] Thus, as a matter of policy, such privileges should be invoked only by persons having a legitimate interest in keeping the information confidential.[19] Thus, only the client may invoke the attorney-client privilege,[20] and only the patient can control use of the doctor-patient privilege.[21] By analogy, only the client should be able to assert the accountant-client privilege. An accountant may not have an independent interest in keeping his client's information secret.[22] The broad language of the first group of statutes, which has led two courts to conclude that the statutory privilege belongs only to the accountant may have created an unnecessary bar to the availability of evidence relevant to the proper disposition of disputes. These statutes should be amended to make clear that the privilege belongs only to the client.

v. Reiter Co., 429 P.2d 653 (N.M. 1967), an aggrieved employee of the accountant's client brought an action for wages. The statute was worded in much the same way as the Illinois statute (*see* note 2 *supra* for the text of each), and the New Mexico court expressly followed the dictum in the Illinois case, allowing the accountant to testify despite the objections of his client.

16. *See* text accompanying note 10 *supra*.

17. In Savino v. Luciano, 92 S.2d 817 (Fla. 1957), the court relied on the general justification for all privileged and confidential communications to support its rulings that the privilege could be waived by the client. It cited the opinion of Judge Learned Hand in United States v. Krulewitch, 145 F.2d 76, 79 (2d Cir. 1944), in which Hand stated that "[t]he justification for the privilege lies not in the fact of communication, but in the interest of the persons concerned that the subject matter should not become public." Waiver was allowed in the Florida case even thought the Florida statute does not expressly permit the client to waive the privilege. *See* text of statute at note 2 *supra*. Nine of the existing statutes do contain such a provision. *See* texts of statutes at note 2 *supra* and chart at note 7 *supra*.

In Weck v. District Court, 158 Colo. 521, 408 P.2d 987 (1965), the court was not directly faced with the question of who had the right to invoke the statute, but stated nonetheless that "the privilege created by the Colorado statute is not the privilege of the accountant but that of the client."

18. *See* Wigmore's four tests for justifying the granting of a communications privilege. 8 WIGMORE § 2285 [cited in Falsone v. United States, 205 F.2d 734, 740 (5th Cir. 1953) and State v. Smythe, 25 Wash. 2d 161, 168, 169 P.2d 706, 710 (1946)]. For an analysis of the accountant-client based on Wigmore's tests, *see* Note 46 N.C.L. REV. 419 (1968).

19. *See* Judge Hand's statement note 17 *supra*.

20. 8 WIGMORE § 2327.

21. 8 WIGMORE § 2386.

22. Of course, an accountant does have an attenuated interest in keeping a client's disclosures confidential insofar as that will help him to develop a reputation for discretion among the businessmen he serves.

A further question is when, if ever, the policy considerations underlying the privilege outweigh the undesirable effects of the concomitant loss of relevant information to the fact-finding process. There are recent indications that some members of the accounting profession feel that the privilege should apply only in situations where the accountant performs a "private" advisory or consulting function and should not be available to an accountant involved in a public audit.[23] However, an argument can be made for granting a properly limited accountant-client privilege in the public audit situation. When an accountant performs a public audit, he is often called upon to examine data relevant to a variety of complex financial, tax, and management problems.[24] To analyze such data properly, the accountant should have access to many of the details of his client's operations which his client may consider confidential. Admittedly, promoting disclosure in order to permit a professional man better to serve his client may not always be sufficient justification for a communications privilege.[25] Moreover, such a privilege cannot be justified solely on the ground that it eliminates the ethical problem posed when a professional man is called to testify about information which he obtained in his professional capacity.[26] Nevertheless, when an ac-

23. Letter from Timothy T. McCaffrey, Manager, State Legislation, American Institute of Certified Public Accountants (AICPA) to Thomas O'Hare, Sept. 7, 1967, on file with the *Michigan Law Review*, indicating that the accounting profession itself is divided on the question of the desirability of accountant-client privilege statutes:

> The Institute has not adopted a position either in favor of or in opposition to legislation creating a privileged status for confidential communications between CPAs and their clients.
>
> . . . .
>
> The primary interest of most CPAs who desire the creation of a statutory accountant-client privilege is to promote full disclosure of information necessary for the preparation of income tax returns. This interest in the creation of a privilege for tax matters, however, is not necessarily compatible with the primary function of public accounts—auditing. Reconciling the interests of these two functions is not always achieved in privilege legislation.

Yet, "[s]ome state CPA societies have sponsored privilege legislation and others will do so in the future." Letter from Timothy T. McCaffrey *supra.*

In the past the AICPA has taken a position against recognition of the privilege. See letter from William C. Doherty, Director of Professional Ethics and Legislation, AICPA, to the Yale L.J., Nov. 28, 1961, in Comment, *Functional Overlap Between the Lawyer and Other Professionals: Its Implication for the Privileged Communication Doctrine*, 71 YALE L.J. 1226, 1248 n.147 (1962). *See also* Report of the Comm. on State Legislation of the AICPA for April 26, 1945; *id.* for Aug. 27, 1956; Letter to State Society Presidents, Jan. 11, 1937, from Comm. on State Legislation of the AICPA, excerpts printed at 73 J. OF ACCOUNTANCY 353 (1942).

24. Katsoris, *Confidential Communications—The Accountant's Dilemma*, 35 FORDHAM L. REV. 51 (1966); Memorandum of the N.Y. State Society of CPA's in Support of "An act to amend the civil practice law and rules, in relation to making confidential communications between public accountant and client privileged communications."

25. Despite the fiduciary relation recognized between bankers and depositors [State *ex rel.* G. M. Gustafson Co. v. Crookston Trust Co., 222 Minn. 17, 22 N.W.2d 911 (1946)], and stockholders and customers [Capital Co. v. Fox, 85 F.2d 97 (2d Cir. 1936)], a privilege is denied in both circumstances.

26. The "point of honor" by which attorneys were granted a personal privilege if testifying would cause them professional ethical problems has not been considered a sufficient reason for a privilege since the late 18th century. 8 WIGMORE §§ 2286, 2290.

countant performs a public audit, it is the public—not the client—which ultimately benefits from any increased disclosure due to existence of the privilege.[27] Certified financial statements are relied upon by prospective creditors and investors.[28] Therefore, it is essential that a certified public accountant's opinion that a financial statement fairly represents the financial position of an audited concern be based on careful examination of *all* relevant materials.[29] To the extent that an accountant-client privilege can assure audited concerns that financial data revealed to accountants will not be disclosed in court, it promotes the public interest in having accurate financial statements.[30]

However, it must be acknowledged that the promotion of disclosure to an accountant by statutory privilege is hindered by the fact that so many states have yet to enact a privilege statute. A client with an interstate business, or even a client who could be found to be "doing business" in a state without a privilege, can never be completely certain that information provided to an accountant will not be disclosed. Therefore, until all jurisdictions enact a privilege, judicial access to information may be effectively limited without realizing the benefits of increased disclosure to accountants. Although this is a factor in considering whether any given privilege statute is achieving its aims, it does not affect the basic policy question of whether the accountant-client privilege even if made effective is justified.

Assuming that the accountant-client privilege has, at least in certain cases, the capacity to promote increased disclosure, and that this outweighs the adverse effect upon the fact-finding process, it can be argued that the privilege still results in a sacrifice of the public's right to inquire into the information which the accountant relied upon in preparing his audit. If members of the public cannot examine such

27. The public interest in this matter is evidenced by the fact that every state has a law regulating the practice of accountancy. *See* 1 & 2 CCH ACCOUNTANCY L. REP. In addition it should be noted that financial statements submitted to the Securities and Exchange Commission, with few exceptions, must be certified. 1 L. LOSS, SECURITIES REGULATION 326, 346 (2d ed. 1961).

28. AICPA, *A Description of the Professional Practice of Certified Public Accountants*, J. OF ACCOUNTANCY, Dec. 1966, at 61.

When an accountant certifies a financial statement, he examines it and certifies that it conforms with generally accepted accounting principles and that it fairly represents the financial position of the audited firm. The Code of Ethics for California accountants spells out the types of opinions which an accountant may express. 1 CCH ACCOUNTANCY L. REP. ¶ 4405, at 1361 (1966).

29. AICPA, *supra* note 28.

30. Corporations are today under such regulatory and economic pressure to receive an accountant's certification and opinion that they will not refuse the accountant access to material information. Many federal regulations require corporations to provide certified financial statements to investors and shareholders. [*E.g.*, SEC Reg. 14a-3, 17 C.F.R. § 240.14a-3 (1968)]. State securities regulation statutes have similar requirements [*E.g.*, N.Y. STOCK CORP. LAW § 77 (McKinney 1944)]. In addition, many potential investors would require such statements as a matter of course, thus bringing economic pressure to bear upon corporations to provide the auditing accountant with all the material information which he requires. *See* Note, 46 N.C.L. REV. 419, 425 (1968).

information when they suspect fraud or negligence, they may be less willing to rely on certified financial statements. Considered in this light the accountant-client privilege may well serve to undermine the utility of certified financial statements. There are, however, several countervailing factors which operate to mitigate the force of this disadvantage. Since a certified public accountant must be independent of the concern whose financial statements he certifies, there is a considerable amount of institutional protection against fraudulent dealing between accountant and client built into the certification system.[31] More important, most of the existing privilege statutes prevent inquiry only into the information disclosed to an accountant during a public audit; they do not prevent inquiry into the procedures used by the accountant in performing his audit.[32] In many cases, this type of inquiry could sufficiently protect the public interest in careful preparation of financial statements. A more effective method of insuring that an accountant cannot use the privilege to escape liability for a fraudulent or negligent public audit would be to include in the statute an exception to the privilege applicable whenever a prima facie case of negligence, fraud, or any crime has been established in connection with the certification of a financial statement.[33] Such an exception to the accountant-client privilege could be judicially imposed,[34] but since the expected benefits could be partially negated if the exception were inconsistently applied, it

31. Rule 1.01 of the Code of Professional Ethics of the AICPA provides that "[n]either a member or associate, nor a firm of which he is a partner, shall express an opinion on financial statements of any enterprise unless he and his firm are in fact independent with regard to such enterprise." 2 CCH ACCOUNTANCY L. REP. ¶ 65,102, at 15,119 (1965). *See also* Committee on Professional Ethics of the AICPA, *Opinion No. 12—Independence*. 2 CCH ACCOUNTANCY L. REP. ¶ 65,102, at 15,129 (1967). Most states have an independency requirement in a code of ethics promulgated by the state agency responsible for the regulation of the accounting profession. *See Code of Ethics Check List*, 1 CCH ACCOUNTANCY L. REP. 181 (1968).

32. An examination of the wording of the statutes, *supra* note 2, shows that only *information* transmitted or communicated to the accountant by his client is protected. The privileges do not draw a curtain around the entire auditing process.

33. The attorney-client privilege is barred as to commications of a client who consults his lawyer concerning a plan or intention to commit a future crime. Regina v. Cox, 14 Q.B.D. 153 (1884); 8 WIGMORE § 2298; Gardner, *The Crime or Fraud Exception to the Attorney-Client Privilege*, 47 A.B.A.J. 708 (1961). This exception may also apply to future torts. *See* Annot., 2 A.L.R.3d 861 (1965). The usual rule in the United States and England for the application of this exception is that there must be enough evidence supporting the charge of illegality to constitute a prima facie case before the court can compel disclosure. *See* Gardner, *supra*, at 710. There are difficult practical problems in the application of this rule, however [Hamil & Co. v. England, 50 Mo. App. 338 (1892)], which might impair either the effectiveness of the limitation or the goals of the privilege. On the one hand a prima facie case of a crime or fraud must be presented while the information which supports the charge is protected from disclosure; on the other hand, if the courts are lenient in demanding sufficient evidence prior to ordering disclosure, clients will not be able to rely on the privilege to protect information from disclosure, and the goal of the privilege will be thwarted.

34. *See* notes 47-51 *infra* and accompanying text.

would seem that this matter should not be left to the uncertainties of judicial construction.

As to an accountant who is acting in a *private advisory capacity*, the best argument for granting a privilege is provided by the similarity between the accountant-client and the attorney-client relationships,[35] particularly with regard to advice given in tax matters.[36] However, the characteristics of the attorney-client relationship which necessitate a communications privilege are usually not present in the accountant-client context.

The attorney-client privilege is intended to assure persons confronted with complex and unfamiliar legal matters that they need not shun professional counsel because of fear that their statements to an attorney will be disclosed in court.[37] There is more at stake than merely a client's need for advice on a perplexing problem; rather, the chief consideration is that an individual have fully informed legal counsel when his legal rights are at stake.[38] Thus, the analogy to the attorney-client privilege supports granting an accountant-client privilege only when the accountant is performing services closely related to a client's legal rights. For example, the work of accountants and

35. Since the attorney-client privilege is the oldest and one of the best-supported communications privileges, dating from the reign of Elizabeth I, argument by analogy to the attorney-client privilege is particularly effective. *See* 8 WIGMORE § 2290 [cited in Radiant Burners Inc. v. American Gas Ass'n, 320 F.2d 314, 318 (7th Cir.), *cert. denied*, 375 U.S. 929 (1963)].

36. The similarity of the work performed by accountants and attorneys in the tax advisory area has resulted in a long dispute between the two professions concerning the proper field of activity for each profession. Aland, *Relations Between Lawyers and Certified Public Accountants in Federal Tax Practice*, 15 ALA. L. REV. 517 (1963); Anderson, *The Tax Practice Controversy in Historical Perspective*, 1 WM. & MARY L. REV. 18 (1957). It now seems to be recognized by the professions [Joint Statement of Principles Relating to Practice in Field of Federal Income Taxation, 37 A.B.A.J. 517 (1951)] and by the courts [Agran v. Shapiro, 127 Cal. App. 2d 807, 273 P.2d 619 (1954); *In re* Bercu, 273 App. Div. 524, 78 N.Y.S.2d 209, *aff'd*, 299 N.Y. 728, 87 N.E.2d 451 (1949)] that both professions can legitimately perform services in this area, although the line of demarcation between the services to be performed by the two professions is not a clear one. In Lowell Bar Ass'n v. Loeb, 315 Mass. 176, 183, 52 N.E.2d 27, 32 (1943), the court stated that "[a] sharp line cannot be drawn between the field of the lawyer and that of the accountant. Some matters lie in a penumbra." *See also* Annot., 9 A.L.R.2d 797 (1950); 56 YALE L.J. 1438 (1947).

An indication of the similarity of the two professions is that accountants are permitted to represent their clients in hearings before the Department of the Treasury [31 C.F.R. § 10.3(a) & (b) (1967)] and before the United States Tax Court [26 C.F.R. § 701.2(a), (d), & (e) (1961)].

37. Hunt v. Blackburn, 128 U.S. 464, 470 (1888).

38. Greenhough v. Gaskell, 47 Eng. Rep. 35, 36, 1 My. & K. 98, 99 (1833):

> The foundation of this rule is not difficult to discover. It is not, as has sometimes been said, on account of any particular importance which the law attributes to the business of legal advisers or any particular disposition to afford them protection. . . . But it is out of regard to the interests of justice, which cannot go on, without the aid of men skilled in jurisprudence, in the practice of the courts, and in those matters affecting the rights and obligations, which form the subject in all judicial proceedings.

This view was reiterated in Hunt v. Blackburn, 128 U.S. 464, 470 (1888).

lawyers may overlap to some extent in the tax area, since neither group can claim exclusive competence in the tax advisory field.[39] On some occasions tax accountants perform services which, while they do not constitute the unauthorized practice of law,[40] are so closely related to law that an attorney performing similar services would enjoy a privilege.[41] Within this area of overlap, accountants and their clients should not be denied a privilege which would be available to attorneys and their client under similar circumstances. Nevertheless, the courts have had great difficulty defining the limits of this area of overlap.[42] Granting the privilege within such an ill-defined area would not only pose great practical problems for the courts, but would also frustrate the purpose of the privilege, since clients could rarely be certain that matters disclosed to an accountant working in the tax field would be found to be privileged.[43] Thus, although there is some justification for conferring an accountant-client privilege in those cases in which an accountant performs services similar to those of an attorney, it is probably impractical to define a privilege in these terms.

On the same rationale, another setting in which communications made to an accountant acting in a private advisory capacity should receive some protection is that in which the accountant is aiding an attorney in the preparation of a case for trial. Some courts, in the absence of a statutory privilege, have extended the attorney-client privilege to communications made to an accountant in such a situation.[44] However, even in a jurisdiction which recognizes this extension of the attorney-client privilege, the factual circumstances triggering its application are not clearly defined.[45] This uncertainty could destroy a client's assurance that the information revealed to an accountant will remain confidential. Thus, the protection of communications to an accountant in such a situation can best be accomplished by adopting a statute expressly creating such a limited privilege.

39. *See* note 36 *supra*. As to other kinds of advice on internal business problems which an outside accountant may provide through what are called "management services," *see* Note, 46 N.C.L. REV. 419, 426-27 (1968).

40. *See* note 36 *supra*.

41. An attorney performing services in this area is privileged unless his work has become exclusively that of an accountant. Olender v. United States, 210 F.2d 795 (9th Cir. 1954); *In re* Fisher, 51 F.2d 424 (S.D.N.Y. 1931).

42. *See* Note 36 *supra*.

43. *See* note 61 *infra* and text accompanying notes 60-63 *infra*.

44. United States v. Judson, 322 F.2d 460 (9th Cir. 1963); United v. Kovel, 206 F.2d 918 (2d Cir. 1961); City and County of San Francisco v. Superior Court, 37 Cal. 2d 227, 231 P.2d 26 (1951). *See also* Reisman v. Caplin, 375 U.S. 440, 449 (1964) for dicta supporting extension. In the past this extension has been denied. Himmelfarb v. United States, 175 F.2d 924 (9th Cir.), *cert. denied*, 338 U.S. 860 (1949), but it appears that the 9th Circuit, which decided *Himmelfarb*, has now changed its position on the matter by its decision in United States v. Judson, *supra*. *See generally* Katsoris, *supra* note 19, at 54.

45. Annot., 96 A.L.R.2d 125 (1964).

The statutory accountant-client privileges have generally been less restricted in application than the common-law attorney-client privilege,[46] even though the former privilege is justified by the similarity of an accountant's advisory function to that of a lawyer.[47] The courts have long applied a number of exceptions to the attorney-client privilege; these exceptions are not reflected in the language of most accountant-client privilege statutes.[48] However, since courts normally limit novel communications privileges when possible,[49] they could read similar exceptions into these statutes. Morever, it might well be impractical for a legislature to draft a statute enumerating all of the judicial exceptions and variations that have become attached to the attorney-client privilege. Yet, the desired result could simply be achieved by expressly equating the two privileges in every respect.[50] This would preserve the ability of the courts to draw upon judicial experience gained in dealing with the attorney-client privilege.

Federal courts have usually held that rule 43(a) of the Federal Rules of Civil Procedure requires application of state statutory privileges such as the accountant-client privilege in nondiversity cases un-

46. Long judicial construction of the attorney-client privilege has developed the present limitations of the rule. They include: (1) the crime or fraud exception (note 33 *supra*). The lack of a similar protection in the present accountant-client privilege statutes suggests the possibility that the privilege might be used by an accountant or his client to shield a fraud effected by the accountant certifying to false financial statements. The statute, without this exception, might also be used by the accountant to hide his own negligence from the court in a malpractice suit brought against him. *But see* note 32 *supra*, and accompanying text. (2) The confidentiality requirement. Communications to a lawyer which are not made in confidence are not privileged. 8 WIGMORE § 2311. Only five of the sixteen accountant-client privilege statutes expressly make this a requirement for operation of the privilege. (3) The relevancy requirement. If a matter is mentioned to an attorney which is within his professional competence but irrelevant to the matter at hand, the privilege is inapplicable. Modern Woodmen of America v. Watkins, 132 F.2d 352 (5th Cir. 1942). None of the statutes expressly makes this requirement for operation of the privilege.

It is true that the courts have shown a hostility to novel privileges and have, in some instances, stated that since the statutes are in derogation of the common law that a strict construction should be applied to them. United States v. Bowman, 358 F.2d 421 (3d Cir. 1966); State v. Donovan, 129 N.J.L. 478. 30 A.2d 421 (1943). *But see* Pattie Lea, Inc. v. District Court, 423 P.2d 27 (Colo. 1967). In Clark v. United States, 289 U.S. 1 (1933), the Supreme Court, justifying an exception to the juror's privilege argued by analogy to the crime or fraud exception to the attorney-client privilege. Thus it is possible that the exceptions to the attorney client privilege will be judicially applied to statutory privileges.

Legal counsel for the AICPA advised the Institute that the accountant-client privilege would not apply to communications concerning the prospective commission of a crime or perpetration of a fraud. Excerpts from Minutes of State Legislation Comm. of the AICPA, Dec. 16, 1966. *See also* Comment, *supra* note 23, at 1247-49 (1962) for an opinion that the crime or fraud exception will be applied to novel privileges.

47. *See* notes 37-41 *supra* and accompanying text.

48. *See* note 46 *supra*.

49. *See* note 46 *supra*.

50. The equation method has been utilized in some states to create a privilege for psychologists. Louisell, *The Psychologists in Today's Legal World*, 41 MINN. L. REV. 731, 734 (1957).

less there is some federal rule, precedent, or statute to the contrary.[51] Similarly, many federal courts have regarded state statutory privileges as binding in diversity actions,[52] although the bases of these decisions are varied and unclear. Some of these courts have ruled that the accountant-client privilege is "substantive" and therefore binding on federal courts in diversity actions[53] under the rule of *Erie Railroad Co. v. Tompkins*.[54] Other federal courts have either cited rule 43(a)[55] or given no reason for reaching this result.[56] However, there are other situations in which federal courts do not give effect to the accountant-client privilege. For example, this privilege cannot be invoked in federal criminal proceedings.[57] Rule 26 of the Federal Rules of Criminal Procedure[58] provides that common-law rules govern the admissibility of evidence in federal criminal cases; since no accountant-

51. FED. R. CIV. P. 43(a):

In all trials the testimony of witnesses shall be taken orally in open court, unless otherwise provided by these rules. *All evidence shall be admitted which is admissible under the statutes of the United States, or under the rules of evidence heretofore applied in the courts of the United States on the hearing of suits in equity, or under the rules of evidence applied in the courts of general jurisdiction of the state in which the United States Court is held.* In any case, the statute or rule which favors the reception of the evidence governs and the evidence shall be presented according to the most convenient method prescribed in any of the statutes or rules to which reference is herein made. The competency of a witness to testify shall be determined in like manner. [Emphasis added.]

Although this seems to bar the operation of state privilege statutes unless such a privilege is also recognized by federal law, the federal courts have generally bowed to state statutory privileges if there is no federal statute, precedent, or rule to the contrary. Annot., 95 A.L.R.2d 320, 327 (1964); Katsoris, *supra* note 24, at 60; 5 J. MOORE, FEDERAL PRACTICE ¶ 43.07, at 97 (2d ed. 1967). Rule 43(a) often does not produce a clear result in this area since questions often arise when a state statute precludes admission of certain evidence and no federal statute, precedent, or rule allows admission. In this situation a division has resulted in the federal courts. Some hold that the old equity practice of allowing state privilege statutes to be controlling should be continued. Baird v. Koerner, 279 F.2d 623, 628 (9th Cir. 1960); Van Wie v. United States, 77 F. Supp. 22, 44 (N.D. Iowa 1948). Other federal courts have held that rule 43(a) provides for the widest rule of admissibility and that state privilege statutes should not be controlling. *E.g.*, United States v. Brunner, 200 F.2d 276, 280 n.2 (6th Cir. 1952). The latter result is probably more in keeping with the philosophy of the rule, but it is not necessarily demanded by its wording.

52. Annot., 95 A.L.R.2d 320, 327-28 (1964); Katsoris, *supra* note 24, at 59.

53. Mass. Mut. Life Ins. Co. v. Brei, 311 F.2d 463, 465-66 (2d Cir. 1962); Miller v. Pacific Mut. Life Ins. Co., 116 F. Supp. 365 (W.D. Mich. 1953).

54. 304 U.S. 64 (1938).

55. Berdon v. McDuff, 15 F.R.D. 29 (E.D. Mich. 1953); Stiles v. Clifton Springs Sanitorium Co., 74 F. Supp. 907 (W.D.N.Y. 1947).

56. Ranger, Inc. v. Equitable Life Assur. Soc'y, 196 F.2d 968 (6th Cir. 1952); Engl v. Aetna Life Ins. Co., 139 F.2d 469 (2d Cir. 1943).

57. United States v. Kovel, 296 F.2d 918, 921 n.2 (2d Cir. 1961); United States v. Culver, 224 F. Supp. 419 (D. Md. 1963); Petition of Borden Co., 75 F. Supp. 857 (N.D. Ill. 1948).

58. FED. R. CRIM. P. 26:

In all trials the testimony of witnesses shall be taken orally in open court, unless otherwise provided by an Act of Congress or by these rules. The admissibility of witnesses shall be governed, except when an Act of Congress or these rules otherwise provide, by the principles of the common law as they may be interpreted by the courts of the United States in the light of reason and experience.

client privilege exists at common law,[59] the privilege is not available in this context. In addition, most federal courts have imposed another significant limitation on the use of the accountant-client privilege by ruling that it does not apply in federal administrative hearings,[60] including hearings held by the Internal Revenue Service.[61] These courts have ruled that such hearings are not "civil actions";[62] therefore, the usual rule that state statutory rules of evidence control in nondiversity civil actions[63] is inapplicable.

On balance, the policy considerations do seem to favor granting a privilege to protect information disclosed to accountants performing public audits; however, this proposed privilege should be carefully limited to permit disclosure when a prima facie case of negligence, fraud, or other criminal conduct which affects the accuracy or reliability of the audit has been established. There is also a need for well-defined limits on the availability of the privilege in situations where accountants act as private advisors, although information disclosed to accountants performing legally oriented services should still be privileged. It is apparent that the existing accountant-client privilege statutes have been loosely formulated without attempting accurately to define the limited areas in which the privilege is actually justified.